

**AGENDA ITEM 3b
FINANCIAL STATEMENT AUDIT MANAGEMENT LETTER COMMENTS
CURRENT YEAR REPORT
AS OF JUNE 30, 2011**

Audit (Report Issue Date): Report to Management for the Year Ended 06/30/10 (11/17/10)

Observation 1: Recognition of Multi-year Contract Expenses

Division responsible: Fiscal Services Division

Observation:

During the fiscal year 2009/2010, CalPERS recorded certain expenses in the general ledger based on the encumbrance of multi-year contract amounts, which resulted in the recognition of expenses that had not yet been incurred. Expenses should be recorded in the fiscal year in which the related goods are received or services are rendered, regardless of the timing of contract authorization, in accordance with generally accepted accounting principles (GAAP). As of June 30, 2010, CalPERS' personnel analyzed expenses greater than \$100,000, by budget line item; expenses that had not yet been incurred were manually reversed out of the general ledger. While the current methodology assures that the financial statements fairly present, in all material respects, multi-year contract expenses, the process results in the following deficiencies:

- a. There is a risk that expenses less than \$100,000, by budget line item, are not recorded in the proper fiscal year in accordance with GAAP.
- b. The process is inefficient as personnel were required to investigate the recorded multi-year contract expense amounts and manually correct certain amounts that were improperly recognized during the fiscal year.
- c. Expenses reported in the Statement of Changes in Fiduciary Net Assets and supplemental Administrative Expenses Schedule had to be corrected for financial reporting purposes.

CalPERS should implement a process to ensure that multi-year contract expenses are reported in the proper period. Multi-year contract expenses should be recorded in the general ledger as the related goods are received or services are rendered.

Management's Response:

IN PROGRESS. Fiscal Services has contacted other state agencies to obtain an understanding of other practices for contract accruals, completed the issue memo and sent it to Macias, Gini, and O'Connell on April 27, 2011, and completed procedures to adjust multi-year contract encumbrances during the year-end closing. Fiscal Services has also contacted each division/project manager to identify multi-year encumbrance balances and determine what portion of the remaining encumbrance is actual accrual for FY 2010-11. Fiscal Services will meet with the Budget Section to evaluate expenses for the multi-year contracts. Target completion date is September 30, 2011.

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Observation 2: Executive Review of Draft Financial Statements

Division responsible: Fiscal Services Division

Observation:

There is currently no process in place to ensure that all CalPERS executives have an opportunity to review the draft financial statements prior to the Finance Committee's approval of the financial statements. Representatives from each of CalPERS' divisions and offices should have an opportunity to review the draft financial statements to ensure proper reporting and disclosure of CalPERS' unique activities and services.

We strongly encourage the Fiscal Services Division to distribute the draft financial statements to the appropriate executive personnel for review prior the Finance Committee's approval of the financial statements. We further recommend that Fiscal Services develop a process to review and respond to the comments and suggestions made by executive personnel to ensure that CalPERS' financial statements offer readers the most thorough and transparent view of CalPERS' financial activities and transactions.

Management's Response:

IN PROGRESS. Fiscal Services is in the process of developing the monthly deliverables applicable to this observation. Fiscal Services will develop, document and implement a process by which executive personnel will be given the opportunity to review and comment on the draft financial statements prior to presentation to the Board of Administration's Finance Committee. Fiscal Services has sent an e-mail to the Financial Reporting Committee members requesting the name of staff who are to receive the executive review copy, scheduled for distribution on October 7th. Target completion date is September 30, 2011.